AD-A286 555

DSMC PRESS
TECHNICAL REPORT, TR 5-94

DEFENSE SYSTEMS MANAGEMENT COLLEGE
FORT BELVOIR, VIRGINIA

THE SOCIOPOLITICAL ASPECTS OF GERMAN INDUSTRIAL ORGANIZATION

A MODEL FOR EASTERN EUROPE?

DR. EDWARD M. KAITZ

Distinguished Professor of Finance at
Marymount University
and
Research Professor at
Georgetown University

TheSociopolitical Aspects of German Industrial Organization:

A Model for Eastern Europe?[1]

Dr. Edward M. Kaitz

Germany's post war renaissance provides an example of a unique but successful adaptation of free market economic theory to a country's specific sociopolitical needs. By promoting a social contract that called for the development of a "social market economy", it pioneered in adapting free market practices to the country's specific needs. For this reason among others, the post war redevelopment of the German economy may provide valuable lessons for the emerging Eastern European nations. Hence, the focus of this article is on a brief analysis of the institutional systems underlying German industrial organization.

INTRODUCTION

Is there more than one form of a free market economy? This is a question rarely asked in the United States either by professional economists or by informed lay people. Perhaps it is because it is assumed, albeit *a priori*, that there is but one acceptable model of such an economy, i.e., the United States with its prescribed emphasis on a *laissez faire* approach to industrial organization and economic regulation.

Dr. Kaitz is a Distinguished Professor of Finance at Marymount University in Arlington, Virginia and a Research Professor at Georgetown University in Washington, D.C. He is former Dean of Georgetown University's School of Business.

But is this a correct assumption? If there is more than one model of a free market economy this would then suggest to those responsible for economic planning in Eastern Europe that they cast a wide net and analyze competing economic models for their adaptability to the potentially peculiar needs of their specific nation. A dialogue of the type that recognized overtly that there is more to the creation of a free market economy than the relatively simple, although far from painless, privatization of previously state-owned industries or businesses would be productive, and especially so if the discussion dealt directly with the micro-economic underpinnings of this future economy. For a free-market economy to emerge , a multitude of complex political, social, and institutional factors need to be surfaced for analysis. Ultimately, it is at the microeconomic level that an economic system either fulfills or fails to fulfill the needs and expectations of the polity.

This article thus suggests strongly that the evolving Eastern European nations take a strong and hard comparative look at the German, Japanese, and American economies in order to:

- better understand how the economy of each of these nations is organized.

- determine the relative strengths politically, socially and economically of each of these three models of behavior, and

- establish a technique for determining "best practice" given the social, political and cultural realities of their individual nation.

WHY GERMANY

In a sense, what is being suggested here is that an analysis be made of the "anthropology" of economic and industrial structure in order to avoid the imposition of an economic order on a people with needs, desires and traditions antithetical to any one given approach. In keeping with this, the central focus of this paper is on a brief analysis of the institutional systems underlying German industrial organization. The choice of Germany as opposed to the United States or Japan is purposeful,to wit:

- Although the German economy is, in its totality, *sui generis*, the greater evidence is that there are significant elements of its overal structure that are adaptable to the needs of other nations.[1]

- Neither the internal operations of German industry nor the struc-

ture of the German economy have been as coherently or as thoroughly researched and analyzed as those of the United States and Japan despite its success in meeting the needs of its people.

- Despite its seeming maturity, the German economy can still be said to be in an evolutionary phase, that is to say, still recovering from some of the long-term effects of World War II (WWII) plus the recent reunification of West and East Germany. In this regard, both Germany and its Eastern European neighbors are experiencing some of the transitional trauma involved in converting a command economy into a free economy.

- As Germany's neighbors, the Eastern European nations represent natural markets for each others goods and services and should, therefore, understand fully German economics and industrial organization. Understanding the uniqueness of one's most powerful neighbor politically and economically makes sense. Given Germany's post WWII political and economic renaissance, there are important lessons to be learned.

- Finally, there is a substantial body of evidence that would support the claim that the German economy is one of the world's most efficient based on any measure of the "return on investment" made to its various stakeholders. Its labor force is the most highly paid in the world. Its economy is more oriented to international markets than any other nation in the world. German infrastructure, whether it be roads or the educational system, seems more closely geared to the needs of the individual than that of any other major industrial nation. In sum, its potential political extremism notwithstanding, Germany appears to work well for its various stakeholders.

Here an example may be helpful. Although the Japanese are generally regarded as the U.S.' greatest competitors internationally, the facts are that Germany is, from time to time, the world's largest exporter of high value-added industrial and consumer goods. The major difference between Germany and Japan lies in the "visibility" of the markets that they have elected to serve (Peters, 1992). The Japanese penetration and position in U.S. markets and other foreign markets is far more visible than that of the Germans. But the fact remains that German firms have out competed U.S. producers in many significant product and geographical areas and can be expected to continue doing so in the future.[2] The question, then, is why? What is there about an economy one-quarter

the size of the United States and one-half the size of Japan that allows it to be a major force economically world-wide, and what does this mean for Eastern Europe? More pointedly, will Germany be as dominant a factor in the emerging Eastern European free economies as it is now in Western Europe? And, if so, what can these nations learn from the German experience of the past 45 to 50 years?

The answer to these questions can, I believe, be found in an analysis of the various institutional systems that underpin the organization and operation of the German economy. These institutional systems are far different than those found in the United States and sufficiently different than those found in Japan to warrant further analysis. As has been concluded previously,"*The German economy, and the adaptive mechanisms which are built into it, must be viewed in this light. On one hand, the German economy has adapted to a modern world. On the other hand, it still adheres to an institutional structure and tradition that relies heavily on the past. The miracle of the German economy has been its ability to transfer the past into the future in a highly adaptive and profitable manner: politically, economically, socially.*" [1]

ARMS LENGTH vs. COLLABORATIVE TRANSACTIONS

For a multitude of reasons, the Japanese and German view of the stakeholder relationship is remarkably similar. In both countries, the business firm is held to be directly responsible for the welfare not only of the stockholders but also of its employees, the communities in which it is sited, and the various state and federal governments of which it is a legal creation. To a significant extent, in both Germany and Japan, the welfare of the employees of a firm is oftentimes treated as being on equal footing with that of the stockholder (Glouchevitch, 1992; Smyser, 1992).

This broadening of the stakeholder concept was not necessarily planned. Rather, the outcome was forced by the weight of national traditions in some instances and by political realities in other instances. One such major force was the recognition in Germany that the political and economic excesses of the past would not be tolerated in the post-World War II period. As such, it was realized that there was a dire need for an economic system that promoted social and economic equity for all strata of society.

This political need was, of course, driven by the virtually total destruction of the German economy during World War II. As is obvious, there was a great need to share the rewards of this rebuilding with the selfsame people who earlier suffered the loss. Without their active support, the country could not be rebuilt. This reality gave rise to the concept of a "social market economy" as it now embedded in both German consti-

tutional and corporate law. It is evidenced, in our opinion, by the German emphasis on "inclusivity," or collaborative as opposed to arms-length transactions, within the overall social system. This concern with inclusivity has, in turn, led to the development of a distinctive form of corporate governance and a managerial ethos that is substantially different from that found in the United States. It has also served to create a cluster of supporting institutions whose operations help to maintain the desired emphasis on inclusivity (Henzler, 1992).

For example, as a result of the complete destruction of its economy during World War II, the typical German business firm was forced to rely more heavily on debt capital than its American counterpart. Given the paucity of equity capital in the post-war period, German industry had no choice but to rely heavily on debt. The resulting debt-equity relationships could not be responsive to any over-riding financial theory or economic concept but rather to the bare-faced reality that equity capital was a scarce commodity. Thus, for industry to be able to rely primarily on debt as the primary source for its long term capital, a number of collaborative efforts had to take place. First, the German government had to provide incentives for high personal savings rate. Without that savings rate, rebuilding industry would have been impossible.

Second, in order to maintain the needed flow of personal savings, the German Central Bank had to implement policies that placed primary emphasis on monetary stability. Any extreme rate of inflation would have indeed eroded not only the country's stock of capital, but the consumer confidence needed period to create this capital. Had consumer confidence in the monetary system eroded, the flow of funds to the corporate sector would have dried up, thus aborting the redevelopment of the nation.

Third, the banking system itself had to be stable, as measured by loan-to-capital and similar measures of financial strength. Moreover, the government had to encourage the development of a few very large banks capable of financing the growth of large scale industry while not discouraging the growth of small, regionally based banks. Last the German government had to encourage long term bank-corporate lending relationships.

Additionally, free market theory notwithstanding, the government had to avoid the type of deregulatory environment that might lead towards the financial disintermediation process as it has been experienced in the United States. For Germany, disintermediation would have been an economic tragedy. In the absence of a dynamic equity-based financing system, disintermediation would have impeded the development and

growth of the small- to medium-sized business firm that is the hallmark of a rebuilt German economy. For small- to medium-size companies to grow and prosper, relationship banking is absolutely essential. Further, any failure to encourage the economic growth of the small business sector could have been seen by the German people as a critical political failure, that is to say, evidence of the lack of political will to avoid the type of industrial concentration that occurred during the Wilhelmine and Nazi eras.

Given these realities, the obvious need in Germany was, first, to recognize the interdependence between industry (*capital*) and its work force (*labor*) and, second, to provide for institutional mechanisms that serve to harmonize the needs of each of these two groups.

In order to gain a better perspective on some of these critical macro- and microeconomic interdependencies, details of a number of institutional systems are reviewed and analyzed below:

IDEOLOGY

Germany is different from the United States with, perhaps, the best explanation of the differences between the two nations found in an exploration of the terms "individualism" and "communitarianism" as these terms are used by historians and sociologists.

The dominant ideology in the United States has been defined as that of individualism, or a political and social system built around the concept of the individual as the key or central actor socially, politically, and economically. Evidence of this commitment to individualism can be found in our legal code with its reliance on an inductively based Common Law, in our view of labor, in our view of the role and responsibility of government, and in our economic ideology.

One facet of our economic ideology relies on a commitment to a free market economy based on the philosophic notions of Adam Smith. Another facet of our economic ideology can be found in our rather steadfast adherence to the Lockeian notion of private property. A third facet is based on our ethical belief that morality resides in the individual and not, as in some European nations, within the State.

These ideological commitments are then made real by the development and structuring of societal and economic instruments consistent with an underlying ideology. Our legal system is one such instrument. The forms of ownership, governance and regulation of our corporate sector is another such instrument or, in this case, set of instruments or institutional factors. In each case, the key factor in the organization and operation of the institution is the rights and responsibilities of the individual. It is around him or her that society is putatively organized.

Germany is different in that the role of the individual has traditionally been subordinated to that of society as a whole. Many of these differences are the result of the effect on Germany of the post-Napoleonic political environment. In 1848, the German people attempted to force the creation of a democratically-based society in the various parts of the land. On balance, they failed but, as a result of the conflict, gradually gained concessions from the ruling elite that became the basis for the organization and operation of many of the present day German institutions. The German welfare system, with its emphasis on the maintenance of the purchasing power of the unemployed and sick, is one such institutional factor. The notion of worker participation, or *Mitbestimmung* as it is termed in German, is another key institutional reality. In a different economic area, Germany's universal banking system is yet another of the key institutions both shaping and shaped by the German ethos.

Although it would be foolish to suggest that the development and growth of these various institutions was based on an overall design, over time their form and content appears to have been molded into an overall pattern which places responsibility for social stability and economic progress more on the institution than on the individual.

Here, the glue that holds the system together may well be the German view of the State along with the ethical belief that morality resides in the government and its institutions rather than in the individual. More understandable for an American would be the idea that the utter destruction of Germany during World War II underscored the need for a new social compact in which the costs of the war were to be shared by all as were any future benefits that might derive from the rebuilding of the country (Hartrich, 1980). Equally understandable to an American would be the desire on the part of the individual German to diffuse the power of the various social, political and economic systems that make up a modern society.

Notwithstanding this, Germany was not created anew after World War II. Many of the key institutions that make up the German economy have histories that derive from the nineteenth century. They have been modified over time, but only in part. Tradition dies hard in Germany and the force of tradition can still be found in the form and interaction of many of these twentieth century German institutions.

CORPORATE LEGAL FORM

As in the United States, German law allows for the ownership of a business to be structured in a multitude of forms, that is to say, as proprietorships, partnerships, and corporations as well as in the more recent development of various forms of limited partnerships and joint

ventures (Ernst and Young, 1991; Roemer, 1989). In this regard, both German and American law have been responsive to economic need. And, because of the limits on stockholder liability that is its hallmark, the corporation is the more common legal form of business organization in both countries. Unlike the United States, however, there are two commonly-used forms of corporate organization in Germany; the "Aktiengesellschaft," or the Ag as it is commonly referred to, and the "Gesellschaft mit beschraenkter Haftung," or GmbH. Both of these legal forms are representative of independent legal entities *(persons)*, with their ownership evidenced by shares of stock. As with their American counterparts, the stockholders are not liable for their company's obligations beyond the required paid-in-capital contribution, subject only to the caveat that the actual funds paid into the corporation are consistent with the initial funding levels set forth in the corporation's bylaws. Here there are significant technical differences in the legal requirements attendant to the formation of a corporation in each of the two countries, but these differences do not appear to impact on corporate operations except, possibly, as the legal structure of the German corporation allows for greater access to debt capital than does the American structure.

However, from a practical perspective, there is little or no operational difference between an Ag and a GmbH. The primary difference between these two key terms is that the shares of an Ag can be traded publicly, whereas the shares of the GmbH cannot. In this regard, the Ag must be regarded as the equivalent of a "publicly owned" and the GmbH as the equivalent of a "privately owned" U.S. corporation.

Consistent with this difference, most large German firms are Ags. However, their number is relatively limited; there are only 2000 Ags in Germany. The more than 300,000 GmbHs are, as is to be expected, small to medium sized firms, that is to say, firms with up to 500 employees and sales up to $300 to $400 million annually. Notwithstanding their size, this latter group of privately owned firms account for 70 percent of Germany's export base. In other words, they are an extremely vital part of the economy and, in many instances, far more influential collectively than the large scale business sector (Smyser, 1992).

However, in keeping with the Germanic tradition of the private ownership of businesses, only 450 of the Ag are registered for trading on or another of the seven German stock exchanges. This suggest either that their owners are not concerned with actively trading their shares or that trading can take place outside the exchange system when the need arises. Or, more importantly, that the typical Ag has sufficient access to capital when needed so as to nullify the need for an exchange listing!

Here, an understanding of the role of Germany's universal banking

system is critical. Since German banks can act both as a commercial banker and as an underwriter, and since there is a long-standing house bank tradition in Germany, the legal and administrative problems attendant to raising new capital are less complex and tedious than in the United States. Moreover, since German banks are actively encouraged to take equity positions in their non-financial corporate customers, it is likely that any well run Ag, publicly traded or not, will have sufficient access to capital to meet any foreseeable business need. In this regard, the integration of the German banking system and its corporate sector is far different from the arms length relationship mandated in the United States. Unlike the United States, Germany has no apparent fear of competition destroying conflicts of interest. However, from at least one perspective, the primary role granted the small- to medium-sized firm can be seen as a politically practical offset to the potential power of the banking system *cum* large scale industrial sector.

INCLUSIVITY REVISITED: CORPORATE GOVERNANCE

The corporate governance process in Germany is structured to reflect the (*current*) desire for inclusivity, here best defined as a collaborative or consensus-oriented approach to the decision-making process. This is accomplished by incorporating into the corporate structure three formal management-oriented systems: the advisory board or *Aufsichtsrat* as it is referred to in German; the management board, or *Vorstand*; and the worker's council, or *Betriebsrat*.

The advisory board, or *Aufsichtsrat*, is somewhat similar in organization and responsibilities to the U.S. Board of Directors in-so-far as this body is ultimately responsible for the proper management of the corporation. However, unlike the U.S. Board of Directors, it does not represent the stockholders *only. Under German law, labor is entitled to a numbr of seats on the Board.* For corporations with more than 500 but less than 2000 employees, labor is entitled to one-third of the seats. In firms with more than 2000 employees, labor's proportional representation on the board is increased to 50 percent, i.e., full worker participation, or *Mitbestimmung* at the policy making level of the corporate organization. Those seats not granted to labor are, of course, filled by the elected representatives of the stockholder group.

Operationally, the *Aufsichtsrat*, a corporate form which was brought into being in 1870 by German law, is the key policy formation body in the corporation. It is this corporate body that is responsible for hiring and firing managers, for setting compensation levels within the firm, and for supervising the actions of the *Vorstand*.

Moreover, by law, members of the *Aufischtsrat* cannot engage in acts

of management nor can any of its members be managers of the corporation that they represent, (a member of the *Vorstand* cannot, also, be a member of the *Aufischtsrat*).

Because of this, and the desire to separate the oversight from the management function, the *Vorstand*, or the small cluster of executives that are designated as the firm's managing directors, are solely responsible for the day-to-day management of the firm. Notwithstanding this, they remain under the supervision of the *Aufischtsrat* as the firm's key deliberative body.

The Worker's Council, or *Betriebsrat*, is unique to German industrial organization. German law requires worker's councils in firms employing five or more people and, moreover, specifies the rights and responsibilities within the firm of this council.

Basically, Worker's Councils are charged with the responsibility for negotiating work standards and conditions within the firm and for setting grievance and other labor related issues as they arise. Although the primary role of the *Betriebsrat* is to protect the interests of the worker, its most significant function is in working with management in the adoption of technological change within the work place. In this regard, the *Betriebsrat* have had a central role in helping both management and labor to adopt new technologies as they become available to German industry. As such, they have been an active force in promoting the continued modernization and upgrading of German technology, and in establishing the level of professionalism needed by the workforce. Moreover, their continued existence speaks to the continuing German desire for an inclusive as opposed to an exclusive industrial system.

Thus, compared to other models of corporate governance, the German model is unique, in that the overall governance of the corporation is separated, in law and practice, from the management process and, in its active recognition of labor's stakeholder rights in the present and future well being of the corporation, and indeed the corporate sector as a whole. These various corporate systems act jointly to maintain management's sensitivity to the needs of the firm's stockholders and employees as well as the community at large. Because the *Aufischtsrat* has effective authority over management, it can modify the actions of the *Vorstand* consistent with the needs and/or desires of the various members of the corporate community. But because labor has a voice in management, any decision must be tempered by an adequate recognition of the needs of the firm's employees.

THE ROLE OF THE BANKING COMMUNITY

Since corporate management cannot be members of the *Aufischtsrat*,

the firms' stockholders must rely on outside directors to represent their interests. In many instances, these directors are drawn from the ranks of the German banking community and, in general, a representative drawn from the senior ranks of the firm's house bank.

Their election to the board is facilitated by the fact that German law stipulates that the common stock of a publicly traded German corporation be issued in bearer form. Given the automatic negotiability that this instrument conveys, most publicly traded corporate shares are normally deposited with a bank. The bank can then, and most often does, act as the voting proxy for the actual owner. The access to the voting rights of these shares, plus the fact that many of the country's major banks also hold substantial ownership positions in these self-same corporations, serves to increase the influence of the bank and its management on the boards of a significant number of major corporations. As is to be expected, the position on the board of influential members of the banking community can give the corporation more ready access to either debt or equity financing, should the need arise.

More critically, membership by a bank's senior executives on the boards of various corporations allows for a freer flow of information between industrial firms and institutions than would otherwise be unavailable. Given their widespread contacts, bank-based board members can be key sources of intelligence for the corporation as well as the catalyst for greater cooperation within the corporate sector. Here, German corporate law is far more permissive than that of the United States in treating possible conflicts of interests and/or collaborative efforts that would be seen in America as being in restraint of trade. It is this hidden power of the Advisory Board that may well be the most critical factor in the overall corporate governance process. Given the influence of the banking community plus the obvious influence of the labor force members of the *Aufischtsrat*, management can be held far more accountable for its actions than in the United States. This accountability, in turn, is supported by the German desire for a consensual approach to corporate decision-making.

Seen in this light, the active role taken in German industry by the banking system and, in particular, its emphasis on wholesale banking, has been critical to the post-World War II redevelopment of the German economy and, in particular, to the development and continued growth of the small- to medium-sized business that is the hallmark of the German economy. Assuming only that the smaller firm remain vital, it can look forward to a continuing relationship with the sources of debt financing that it needs to either continue or expand business operations. Moreover, the banking system maintains the expertise needed to handle

the foreign transactions that are one of the key elements of a successful export program. For the smaller firm that cannot afford to maintain in-house expertise in these matters a relationship banking system is an essential.

THE MITTELSTANDISCHE INDUSTRIE

The German economy is unique in yet another respect. It is the only major industrialized nation whose economy is heavily dominated by the small- to medium-sized firm, or the *Mittelstand*, as it is commonly referred to in Germany. For example, in a recent listing of the world's 1000 largest financial and non-financial corporations, there were only 39 German entries. More than 300 United States and Japanese firms were listed. Of more interest to this discussion is the fact that *Mittelstand* firms account for more than 70 percent of Germany's export base. In comparison, it is estimated that equivalent-sized firms in the United States account for no more than 10 percent of the U.S. exports.

In order to understand the economic strength of the *Mittelstand*, a number of historical, political, economic and cultural factors need to be properly understood. Key among them is the long standing German tradition of family-owned businesses. Whereas England may well be classified as a "nation of shopkeepers," Germany might well be termed a nation of small, family-owned businesses, a tradition dating back to the 12th century Hanse, or guild system. It is this system that gave birth to the apprenticeship tradition that is alive in Germany even today.

However, the more modern *Mittelstand* firm is distinguished in two ways. First, most firms that fall into this category are capital-intensive, technology-oriented firms dominated by a managerial philosophy that places heavy emphasis on maintaining a highly skilled and technologically astute work force. Second, given the relatively high cost of labor in Germany, most of the *Mittelstand* pursue a niche strategy by actively seeking to produce the highest quality product in its class, albeit at the highest price. Moreover, as noted above, they are patently export-oriented and, given their focus on niche marketing, oftentimes the most dominant firm in a number of globally-based industries.

Many observers regard this group of firms as the backbone of the German economy. Although there have been a recent spate of articles suggesting that some of the *mittelstandische* firms are beginning to experience business difficulties, currently traceable to (1) the strength of the German mark in international markets, (2) to the relatively high cost of labor in western Germany and (3) to the costs of integrating the former East German economy with that of western Germany. The less-spoken evidence on the various problems noted above would suggest that the

strength of this sector of the German economy is relatively unimpaired.

More critical to a discussion of this type is the persuasive evidence that both the German people and the German government recognize that certain changes have to be made at the macro- and microeconomic policies if the German economy is to remain as strong and as vital as it has been in the past. Consistent with the Germanic emphasis on inclusivity, there appears to be a growing consensus that sacrifices may need to be made by various segments of the economy and social structure if the competitive edge of German industry is not to be sorely blunted.[6]

If the past is prologue to the present, it seems reasonable to assume that these changes will be made.

EDUCATION AND ECONOMIC STRENGTH

Any discussion of German industrial organization failing to include at least a minimal note on the German educational system would be incomplete. The reason for this statement is straight forward; with its highly articulated vocational education and apprenticeship training programs, the German educational system is patently organized to support the needs of German industry. Except for the relatively minor percentage of teenagers who go on to university level education, all German youth are required to complete a minimum of 2-3 years of vocational education plus an apprenticeship training program.

Unlike their counterparts in many other nations, these industry and workskills specific programs are extremely rigorous and most normally involve 2-days a week in classroom setting and 3-days a week on the job. Moreover, the educational and professional standards set for these programs are rigorous. Exit examinations testing both the theoretical and practical knowledge of the student are required with standards for these examinations set jointly by agencies of the various German governments and "public corporation" industry associations.

A student failing to pass these examinations will find his job opportunities limited. Conversely, for the successful student desiring to climb the well paying career ladders that have been created in the greater majority of German business firms, additional tuition free education to the *Meisters* level, and sometimes beyond, is available.[7] Although Germans rarely talk about upward mobility, the general availability of tuition free highly structured educational programs from the kindergarten through post-graduate university level serve to provide to capable and willing student with sufficient opportunity for personal growth.

In order to maintain the technological edge that is an essential element of German industrial strategy, German industry, and the

mittelstandische industrie in particular, maintain a strong and continuing relationship with the German educational system. Industry actively supports these programs both professionally and financially recognizing overtly that a heavy portion of the comparative advantages gained worldside by German industry rests on the continuing development and upgrading of its human resource capabilities.

SUMMARY

Central to this discussion is the tacit assumption that long term adaptability and vitality of an economy is based more on microeconomic, or the underlay of institutional systems that make up a nation's infrastructure, than its macroeconomic policies.

This statement is not meant to impugn the relevance or importance or macroeconomic policies and practices but rather to suggest that macroeconomic policies and practices are just that; economy level analyses and potential solutions to a series of problems and possibilities created by the somewhat more mundane operations of the business sector as it interacts with cultural, social and political realities of a nation and today, perforce the world! Without these microeconomic systems, no economy is going to develop and mature since it is these systems that the polity "touches and feels" daily.

The existence of an adequate retail distribution system for essentials, and the availability or jobs for both the skilled and unskilled is far more important ultimately to the development and growth of a free market economy than the philosophy or content of the fiscal or monetary policy that a nation may invoke as it seeks to transform itself from a command to a free economy. And, as I believe the German example shows vividly, the success of any economic system rests ultimately on the dignity of the people.

They must have a stake in the economy at both the macro- and microeconomic level which they regard as equitable and just. The mere privatization of industry in and of itself is not sufficient to the task of economic growth. Particularly in nations with pronounced socialistic tendencies, the worker must feel that he has a participative right in the industry in which he works. Except as the individual has the faith in the system, there can be no viable transition from a command to a free economy. And, holding aside for the moment, the macroeconomic problem of a stable currency and an equitable tax system, it is at the microeconomic level at which this faith must be developed.

To the extent then that economics is an inexact science, it would appear that those responsible for economic planning in the various East European nations should be actively involved in the type of comparative

analyses that are being suggested here. Given that the now rather large number of free market economies afoot in the world have followed different developmental paths at both the macro- and microeconomic level, there are important lessons that may be learned.

This then, is the central thesis of this article; a brief for a more intensive look at what must be termed here "*comparative political economics*."

REFERENCES

Ernst and Young. (1991). Doing Business In Germany, New York: Author.

Glouchevitch, P. (1992). Juggernaut: The German Way of Business. New York: Simon and Schuster.

Hartrich, E. (1980). The Fourth and Richest Reich. New York: MacMillan.

Henzler, H. A. (1992, July-August).The New Era of Eurocapitalism. *Harvard Business Review*, 30-51

Peters, T. (1992, February). The Japanese May Be Getting the Press, but the West Germans are Getting the Business. *Across The Board*

Roemer, K. (1989). Facts About Germany. Munich: Bertelsman Lexikon Verlag.

Smyser. W. R. (1992). The Economy of United Germany. New York: St. Marten's Press.

ENDNOTES

1. A substantial portion of the material in this article is based on the research that forms the analytic base for the three volume publication, *The Effects of a Scale-Down in Acquisition Budgets on the U.S. and German Defense Industrial Base*. The author was the principal investigator in this joint U.S.-German research project. Project funding was provided by the U.S. Department of Defense.

2. This statement, admittedly, could be patently false. If so, the error is that of the author whose primary background is in Financial Economics and, secondly, in Industrial Organization. If there is literature that addresses this issue, the author has not been exposed to it.

3. According to press reports, the U.S. Department of Labor is now investigating the German system of vocational education for its applicability to the United States. In the opinion of the author, there is a substantial amount of German practice in this area that could be adopted usefully by the United States.

4. German industry is concerned about the issue of competition as it is created by potentially non-competitive wage scales as evidenced by the fact that both BMW and Mercedes-Benz are due to assemble cars in the United States for the domestic market. However, this condition may be more a reflection of Japanese competition in this industry than solely a response to the wage scale problem. As of the moment at least, other elements of the German industrial base do not appear to be overly concerned with the problem. It should be noted, however, that slightly more than 2,000 German-owned firms have located administrative and production facilities in the United States.

5. See Endnote 1 for the basis for this quotation.

6. A number of articles have appeared in the popular press indicating that representatives of the German government have been meeting with their counterparts in industry and labor to work out the social compact that will be necessary to implement if Germany is to remain as highly competitive as it is now. Although there is no way of predicting the future, if the past is any guide, it is likely that the essential political and economic compromises will be made.

7. The term Meister translates as "Master" as in Master Mechanic or Master Plumber in English. However, in Germany this title is treated as an honorific in recognition of the ten years of schooling, at minimum, needed to sit for the exams that qualifies one to be a Meister. A Meister is paid about double the salary normally paid a journeyman worker in a German plant in recognition of this achievement. As is to be expected, the Meister is very much responsible for the formal and the on-the-job training of apprentices under various federal and state guidelines.

SECURITY CLASSIFICATION OF THIS PAGE

REPORT DOCUMENTATION PAGE

Form Approved OMB No.

1a. REPORT SECURITY CLASSIFICATION Unclassified	1b. RESTRICTIVE MARKINGS
2a. SECURITY CLASSIFICATION AUTHORITY	3. DISTRIBUTION/AVAILABILITY OF REPORT "A" distribution for public release; distribution unlimited.
2b. DECLASSIFICATION/DOWNGRADING SCHEDULE	
4. PERFORMING ORGANIZATION REPORT NUMBER(S)	5. MONITORING ORGANIZATION REPORT NUMBER(S) Defense Systems Management College Tech Report 5-94
6a. NAME OF PERFORMING ORGANIZATION Georgetown University 6b. OFFICE SYMBOL (If applicable)	7a. NAME OF MONITORING ORGANIZATION Defense Systems Management College
6c. ADDRESS (City, State, and ZIP Code) Georgetown Washington, DC 20057	7b. ADDRESS (City, State, and ZIP Code) 9820 Belvoir Road, Suite G38 Fort Belvoir, VA 22060-5565
8a. NAME OF FUNDING/SPONSORING ORGANIZATION Defense Systems Management College 8b. OFFICE SYMBOL (If applicable) RCID	9. PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER MDA 903-91-C-0225
8c. ADDRESS (City, State, and ZIP Code) 9820 Belvoir Road, Suite G38 Fort Belvoir, VA 22060-5565	10. SOURCE OF FUNDING NUMBERS PROGRAM ELEMENT NO. | PROJECT NO. | TASK NO. | WORK UNIT ACCESSION NO.

11. TITLE (Include Security Classification)

The Sociopolitical Aspects of German Industrial Organization: A Model for Eastern Europe?

12. PERSONAL AUTHOR(S)

Dr. Edward M. Keitz

13a. TYPE OF REPORT	13b. TIME COVERED	14. DATE OF REPORT (Year,Month,Day)	15. PAGE COUNT
Technical Report	FROM ______ TO ______	October 1994	

16. SUPPLEMENTARY NOTATION

17. COSATI CODES			18. SUBJECT TERMS (Continue on reverse if necessary and identify by block number)
FIELD	GROUP	SUB-GROUP	Acquisition strategy, defense budgets, international comparison, indsutrial structors, financing, education

19. ABSTRACT (Continue on reverse if necessary and identify by block number)

Germany's post war renaissance provides an example of a unique but successful adaptation of free market economic theory to a country's specific sociopolitical needs. By promoting a social contract that called for the development of a "social market economy", it pioneered in adpating free market practices to the country's specific needs. For this reason among others, the post war redevelopment of the German economy may provide valuable lessons for the emerging Eastern European nations. Hence, the focus of this article is on a brief analysis of the instituitonal systems underlying German industrial organization.

20. DISTRIBUTION/AVAILABILITY OF ABSTRACT	21. ABSTRACT SECURITY CLASSIFICATION
☑ UNCLASSIFIED/UNLIMITED ☐ SAME AS RPT. ☐ DTIC USERS	Unclassified

22a. NAME OF RESPONSIBLE INDIVIDUAL	22b. TELEPHONE (Include Area Code)	22c. OFFICE SYMBOL
Dr. Franz A. P. Frisch (COTR)	(703) 805-2525	DSMC-RCID